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UNCLAS SECTION 01 OF 03 SINGAPORE 003211

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TAGS: ECON EFIN PGOV CH SN
SUBJECT: SINGAPORE-BASED EXPERTS WEIGH IN ON THE ASIAN ECONOMY

¶1. (SBU) Summary: Southeast Asia is better positioned than in recent memory to face the challenges presented by a slowdown in the global economy, especially in China, according to several Singapore-based economists and financial analysts. These economies inevitably will feel the pain of a downturn, especially a slump in electronics exports, but ongoing restructuring and outsourcing, particularly in Indonesia, Malaysia, Thailand, will help mitigate the risks involved. All of the analysts were skeptical about the sustainability of China's high growth, but differed on how serious its economic problems were. The most pessimistic argued that China's "hard landing," caused by over-investment and the bursting of several sectoral bubbles, would result in no more than 3 to 5 percent GDP growth in 2005. Southeast Asia's substantial foreign exchange reserves would help cushion the impact of China's economic woes. A hard landing might actually benefit Southeast Asia, one analyst argued, as global investors shifted their focus back to the region as a place better equipped to absorb investment. That said, Southeast Asian economies, largely restructured since the 1997 financial crisis, remain vulnerable to the risks of overexposure to China. Of particular concern is that China continues to follow the more volatile pre-1997 growth model discarded by its neighbors. One analyst warned that faced with a severe slowdown, China might no longer behave as "graciously" with its neighbors as it is now when its economy is still in an upturn. End summary.

¶2. (U) Post took advantage of recent visits by a number of INR analysts to organize a conference entitled, "The Asian Economy: Internal Changes, External Challenges." The all-day conference brought together a number of Singapore-based Asia-watchers who spoke on topics ranging from how global trends are affecting Asia to the impact of Asian economic trends on the global economy and, in particular, China's role in the region.

The Global Economic Slowdown: Not all News is Bad for Asia
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¶3. (U) Asia's trading nations face new challenges due to a convergence and tightening of a number of variables that underpin the global economy. Manu Bhaskaran (Head of Economic Research for Centennial Group Holdings) singled out a number of cyclical demand drivers at play in this scenario: weakening demand among the OECD and China; a rise in global interest rates; a tightening fiscal policy in the U.S.; a sharp decline in global excess liquidity since 2000; an end to the housing boom in many economies; and rising oil prices. Not surprisingly, Bhaskaran explained, most major economies were forecasting slower growth for 2005. For Asian countries in particular, Bhaskaran predicted an increase in the frequency of economic shocks related to electronics exports resulting from the industry's shorter cycles, price volatility and slumping global demand.

¶4. (U) Not all the news is bad, however, Bhaskaran said. Structural positives also exist, most visibly in terms of global competitive pressures that require companies to restructure in order to increase returns. Outsourcing, he argued, was still at an early stage, with far more relocation of production to come. Regionally, he cited the reemergence, or "returning to normal," of Southeast Asia -- particularly Indonesia, Malaysia and Thailand -- where economies have begun to grow again. This has triggered a new investment cycle, particularly in infrastructure. India's growing competitiveness in manufacturing was also an encouraging development in terms of this overall restructuring process, Bhaskaran said.

Shifting Trade, Investment and Consumer Debt Patterns
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¶5. (SBU) China's rise as an economic powerhouse has changed the nature of Asia's economies. Acknowledging that the movement of trade surpluses (with the U.S. and the EU) from the rest of Asia to China is an old story, beginning in Hong Kong as early as 1993, Clifford Tan (Director, Asia-Pacific Economic and Market Analysis, Citigroup) noted that this trend was having a significant impact on the region; all the major Asian economies were now running surpluses with China, the direct result of supplying the raw materials and

semi-finished inputs that China's industries require. Tan cited Japan, South Korea and Taiwan for having leveraged the China platform most effectively to advance their own growth. Japan, he said, was particularly successful, with Japanese companies achieving the world's highest rates of returns on their Chinese investments. The resulting increase in cash flows were in turn fueling increased capital expenditures in Japan and further Japanese investments in the region.

¶6. (SBU) With the Asian Financial Crisis and its related sea of bad debts a thing of the past, cash was again flowing into Southeast Asia, observed Tan. With so much attention focused on China, however, the resulting slack in corporate demand for domestic and intra-regional investment was being picked up by rising consumer demand instead. This phenomenon, Tan said, was amplified by a "dearth of ideas in corporate Asia" about what to do with all the liquidity (except to reinvest it in China). Manu Bhaskaran similarly noted the trend towards increasing consumer debt in Southeast Asia. He saw this development as a double-edged sword, reflecting a degree of resiliency in these economies, but also the potential for a consumer debt crisis if the borrowing binge continued unabated, much as what happened in South Korea.

China's Economy: Careful With That Landing

¶7. (SBU) All of the conference's speakers were skeptical about the sustainability of China's high growth, but differed on how serious China's economic problems were. Manu Bhasakaran questioned how China, with its "hubris-generated" growth, could avoid a hard landing (which he defined as a drop to 4-5 percent GDP growth). It was too late for China's leaders to orchestrate a soft landing, he explained: "Bad lending has financed bad investment." China's primarily supply-sided growth had fueled a number of sectoral bubbles that continued to feed off further excessive lending. In the absence of sufficient data, Bhaskaran observed, it was difficult to predict when China's economy would slow, or how Chinese leaders would respond to inevitable social disruptions.

¶8. (SBU) PK Basu (Managing Director, Robust Economic Analysis) lambasted China's "horrible" growth model. With asset growth exceeding 20 percent the past two years and non-performing loans (NPL) equivalent to 40 to 50 percent of GDP, Basu claimed that these levels far exceeded anything reached in Southeast Asia in the run-up to the 1997 financial crisis or in Japan. The Chinese leadership's focus on the NPL problem offered a glimmer of hope, Basu contended, but the overall momentum and pervasiveness of NPLs in the economy would nonetheless be extremely difficult to slow down without harsh administrative measures. The most bearish of the speakers, Basu forecasted a hard landing for China in 2005, with GDP growth of only 3 to 4 percent (note: other speakers argued that China's economy was still performing well enough to achieve growth rates between 7 and 9 percent.) Southeast Asia would not escape unscathed, Basu said, but healthy foreign exchange reserves would help cushion the blow (as they would in China). Additionally, Southeast Asia stood to benefit from China's hard landing as global investors shifted their focus back to the region as a place better equipped to absorb investment.

¶9. (SBU) Clifford Tan said he was "very concerned" about the China growth model and that much of the economic "street" research on China was "doggedly compromised," leaving important questions unanswered. The situation was exacerbated, he explained, by the many international investment banks jockeying for China's IPO business and restrained in their criticism of Beijing. Most Southeast Asian countries were forced to scramble for a new growth paradigm in the wake of the 1997 financial crisis, having been jolted into the realization that the old growth model was too risky in the long run, Tan explained. China, on the other hand, continues to the adhere to this old model, grabbing growth-related low hanging fruits where it can. Whereas Southeast Asia was allowed to continue along this path for more than two decades, Tan admonished that the financial markets, having been burned so severely before, would not be so forgiving this time with China, perhaps giving China the "thumbs down" within another 5 years or less. Tan said that Southeast Asia would feel considerable pain during this process given its increasing dependence on the Chinese economy as a driver for its own growth.

¶10. (SBU) Van Anantha-Nageswaran (President, Libran Fund) worried that strong China-led export growth in Southeast Asia was postponing needed economic reforms. Yit Fan Wong (Managing Director, Country Risk Management, DBS Bank) argued that the impetus for economic reform in Southeast Asia -- company delistings, consolidations, better accounting, political reforms -- was not so much dampened by "China exhuberance" factors, as driven by the earlier experiences of the 1997 financial crisis. The problem with absorbing excess cash flow, Wong said, was that Southeast Asian companies were

still overly cautious, reluctant to borrow and more focused on cutting costs and increasing productivity. Set against this backdrop, Wong explained, China had been very careless about its investment returns and its costs were rising. With a 1997-style crisis looming in China, Southeast Asian countries might reverse direction and begin moving away from closer proximity to China's economic orbit over the next three to five years. Under this scenario, Wong advised, China might no longer behave as "graciously" with its neighbors as it is now when its economy is still in an upturn. This could translate into very different economic and political relations with other countries in the region.
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